Supreme Court of the United States

OCTOBER TERM, 1953

No. 423

LLOYD M. BENTSEN, SR., et al., *Petitioners,*

v.

EMERY C. BLACKWELL, et al., *Respondents.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR PETITIONER

OPINIONS BELOW

The memorandum opinion of the District Court (R. 34-46) has not been officially reported. The opinion of the Court of Appeals (R. 50-54) is reported in 203 F. 2d 690.

JURISDICTION

The judgment of the Court of Appeals was entered on April 27, 1953 (R. 55). Petitions for rehearing were denied on July 27, 1953 (R. 55). The petition for a writ of certiorari was filed in this Court on October 21, 1953 and was granted on December 7, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTION PRESENTED

This is a local land dispute in which purchasers of citrus land in the Rio Grande Valley of Texas seek to invoke federal jurisdiction by pleading § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2). Does this Section apply to a purely intrastate transaction where the sale is completed without the use of the mails or interstate commerce, but some time thereafter the executed documents evidencing the completed transaction are forwarded by mail to the purchasers?

STATUTE INVOLVED

Section 12(2) of the Securities Act of 1933, as amended, 15 U.S.C. § 77*l*(2) reads as follows:

"Any person who—

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> sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 22(a) of the Act, 15 U.S.C. § 77v(a) provides that the federal district courts shall have jurisdiction

> "concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title".

The full text of Sections 5, 22(a) and Section 2(1) and the relevant portion of Section 2(10) of the Act are to be found in the Appendix to this brief.

STATEMENT OF THE CASE

The present action was filed in the United States District Court for the Southern District of Texas by eight plaintiffs, residents of the State of Texas,[1] against your three petitioners, residents of the State of Texas, and twelve other residents of the same State (R. 1). The controversy relates to the sale of certain citrus land located in Hidalgo County, Texas, in the Rio Grande Valley. The facts are as follows:

The eight plaintiffs purchased the land in question from one of the defendants, Pummill Development Corporation, in 20 and 40 acre parcels, and paid for citrus trees planted or to be planted on their tracts. The price was generally $8,000 for a 20 acre tract plus $2,500 for the trees planted or to be planted on the tract (e.g. R. 5, 6, 7).[2] Most of the purchasers also entered into contracts with another of the defendant companies, Pummill Management Company, which agreed to take care of the trees in question for a fee of $1 per acre per month and the cost of labor and material expended (R. 3, 5, 6, 7, 8, 9, 10). The purchasers under their care contracts agreed to set up and did set up a fund in a local bank to be drawn on by Pummill Management Company. As the money was expended, Pummill Management Company forwarded by mail monthly a statement of

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[1] One other Texas resident intervened as plaintiff (R. 26-28).

[2] One couple obtained the 20 acre tract for $7200 (R. 5-6).

the expenditures made on the purchasers tract. Under the care contract the owner was then obligated to replenish the bank deposit (R. 30).

The complaint alleged that the land in question was part of a block of 800 acres offered to persons resident "outside of the Rio Grande Valley of Texas", "together with a property management or care contract, the whole transaction being treated as an investment by both buyer and seller." (R. 2). It was then alleged that the transactions were induced by false representations of some of the individual defendants (R. 14, Par. VII, 3), and that the other defendants in various manners aided the said defendants (R. 13, et seq., Par. VII).[3]

Plaintiffs alleged that the sale of the land coupled with the agreement to care for the land made the transaction the sale of an investment contract and therefore of a security under the Securities Act (R. 2). The decision of this Court in *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293, was relied on (R. 3).

The use of the mails was alleged in the following manner:

The purchase of the land was in each case made on a personal visit of the purchaser to the property in Hidalgo County, Texas,[4] and payment was made at the time. In some cases the payment was all in cash (R. 3, 9, 27) and in others by cash and notes (R. 5, 6, 7, 7-8, 8).[5] Deeds to the land were executed the same day and recorded in

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[3] In the case of your petitioners it is alleged that their participation consisted in the fact that they had been the former owners of the property and had a vendor's lien on the property (R. 13, 14, Par. VII, 1). This is accompanied by allegations that the vendor's lien was "fraudulent" and that by this means the petitioners were participating in "spoils and plunder." The other defendants are counsel who organized the land selling company, the secretary of the caretaking company, various brokers, and a bus driver for the land company (R. 13-15).

[4] E.g., as to four of the plaintiffs, it was alleged that they were induced by one of the broker defendants to make a trip from their homes in another part of Texas to the Rio Grande Valley (R. 15, paragraph 8).

[5] One purchaser traded some other land in Pecos, Texas, in part payment (R. 4).

the purchaser's name (R. 4, 5, 6, 6-7, 7-8, 8-9, 9-10). Generally on the same day that the plaintiffs purchased the land from the Development Company, Pummill Management Company "executed and delivered to the said Plaintiff a care contract", agreeing to care for the property on the terms stated above (R. 28, 5, 6, 7, 8, 9, 10). *The transactions were thus completely entered into and all agreements made and concluded by face to face personal discussions in Hidalgo County, Texas, without use of the mails or any means of interstate commerce. This included the purchase of the land, the deeding of the property and the execution of the care contract. No allegation or contention to the contrary is made.*

In each case, however, it is alleged that the warranty deed to the property and the care contracts as well, were at a later date forwarded to the plaintiffs at their residences through the mail.

This is the sole basis of jurisdiction claimed and considered by the court below. In the language of the complaint, it was only "after" the oral representations complained of had been made and after the contracts had been entered into for the purchase of the land and care of the trees, that the mails were used to deliver copies of the documents previously executed (R. 11-12).[6]

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[6] Although this does not appear clearly from the complaint, it was argued by respondents in their opposition to the Petition for Certiorari and is conceded that the occasion for the use of the mails was as follows:

The deeds that were executed on the same day were presented for recordation in the appropriate county office in Hidalgo, Texas. After being recorded, the deed with notice of recordation was mailed to the purchaser at his home.

As to the care contract, that was executed at the time of the purchase of the land, but since the land was not in most cases planted to citrus trees and the monthly $1 an acre fee for care of the trees under the care contract as well as the expenses of such care would not commence until the trees were planted (R. 30), the executed contract was left with a blank space for the date when the trees would be planted and the obligation of care actually begin. This took in each case several weeks. The blank in the previously executed contract was then filled in by Pummill Management Company and the mails were used to send the contract to the purchaser.

The Rulings Below

The District Court (Allred, J.) dismissed the complaint, stating:

> "It is clear that plaintiffs have framed their complaint with an eye to S.E.C. v. W. J. Howey Co., et al., 328 U.S. 293. In the words of counsel for defendant, Pummill: 'These residents of Texas, having read some cases and being anxious to secure Federal jurisdiction for trial of land fraud suits have plead in a manner calculated to obtain Federal jurisdiction.' Plaintiffs almost succeed in doing this; but, for reasons hereafter set out, I hold they have not." (R. 38)

After holding that no sale of a security was alleged (R. 38-41), Judge Allred also ruled that the use of the mails was insufficient, since the alleged false statements were not made by use of the mails, and the only use of the mails was for delivery after sale (R. 41-45). He relied on and quoted extensively from *Kemper* v. *Lohnes*, 173 F. 2d 44 (CA 7 1949).

On appeal, the Court of Appeals for the Fifth Circuit reversed on both points. It held that the complaint adequately alleged that a security was involved (except in the case of two of the plaintiffs who may not have executed care contracts) (R. 53, 54). It also said that the use of the mails to deliver the "deeds and management contracts" was sufficient to bring the transaction within Section 12(2) of the Act (R. 54).

Certiorari was taken here limited to the question of the construction of Section 12(2) of the Securities Act. Petitioners specifically stated in the petition that they believed that the Court of Appeals erred also in holding that the sales of land in question were investment contracts and therefore securities. However, in the context in which the matter came to this Court on the complaint alone, the question was merely one of construction of the pleadings not meriting review by this Court under its stated

standards. The petition as granted was accordingly limited to the question of Section 12(2).[7]

SUMMARY OF ARGUMENT

I

Section 12(2) of the Securities Act gives a civil remedy of rescission or damages only against one who "sells" a security "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication" which is false or misleading. In the present case no allegation is made that any means of interstate commerce were used or that a prospectus was used. The transaction was a local real estate transaction concluded face to face in which the mails were used only to deliver documents *after* the sale was concluded.

It cannot be held that the securities were sold "by the use of the mails" within the meaning of the statute. The sole use of the mails was for delivery of the documents constituting the alleged security *after* sale. The concept of delivery after sale is distinct from the concept of sale. In other sections of the statute relating to the registration of securities with the Securities and Exchange Commission, the Congress made this clear by applying those provisions of the Act to the use of interstate commerce or the mails both "for the purpose of sale or for delivery after

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[7] If it should be necessary after action by this Court, petitioners will present to the trial court, evidence to establish that no security sale was involved.

For example, at trial, it would be established, among other things, that the allegation that the land was to be planted to "citrus" conceals the fact that each purchaser made his own managerial judgment, and had various percentages of grapefruit, valencia oranges and even tangerines planted on his land. These and other facts which have already been admitted on depositions, will, we believe, clearly establish that there is no basis for the allegation that a security is involved in these transactions, and that they are in fact ordinary land transactions. We trust, of course, that a ruling of this Court on the issue presented by this petition will make such a trial unnecessary.

sale". The failure so to provide in Section 12(2) is a clear indication that Congress intended the section to apply only to a sale and not to a delivery after sale. This, of course, disposes of the matter.

In addition, the security was not sold "by the use of the mails" "by means of" the prior face to face oral communication. The statute does not apply to a transaction completed face to face within a state. The terms of the statute make it clear that a civil remedy applies where the security is sold by a written false communication, i.e., a prospectus, transmitted in interstate commerce or through the mails, or where the sale is made by false oral communications by interstate telephone. The language of the statute does not permit liability in other circumstances.

There is no necessity for construing the civil liability section in the same way as the criminal sections of the statute since the criminal sections are differently and perhaps more broadly phrased. In any event the criminal sections have never been construed by this Court to apply as broadly as the court below applied the present civil section.

II

All the parties on both sides are residents of the State of Texas. The real estate involved is situated in Texas. The State of Texas provides adequate laws and courts to protect its citizens against fraud in local transactions. The Texas Blue Sky law has an identical definition of "security" to that contained in the federal Act and a civil relief section. The common law grants adequate relief if the transactions are held not to be securities but merely real estate sales. Evidence to this effect is at hand in earlier actions with substantially identical allegations commenced against petitioners by respondents' counsel. In those actions reliance was placed upon state and not federal law, federal jurisdiction being there established by diversity. The protection of investors will not be furthered by extending a forum in the federal court to plaintiffs in local real

estate transactions in addition to their completely adequate local remedy.

III

Extending federal jurisdiction to cover this case will require the federal courts to entertain a great number of actions of an essentially local nature. The statutory definition of security is broad, as the ruling below shows. Mortgage bonds on homes are also securities. So are promissory notes. Under the decision below, local controversies could flood the federal courts. And no restraint by any government agency is available in the case of civil actions.

IV

No congressional purpose in enacting the Securities Act would be furthered by the construction of the court below. The basic assumption of that construction is that Congress meant to exert its power to the full constitutional extent permitted. There is no basis for this assumption in the legislative history or the purposes of the statute. The legislative history shows an affirmative intention to exclude local transactions from the scope of the Act. It shows a specific understanding by the Congress that state Blue Sky laws adequately covered local transactions. It shows an intention that the Securities Act shall cover only transactions of an interstate or national character. The Congress expressly stated that it did not wish to extend the statute "beyond the need of public protection."

ARGUMENT

I. The Statutory Language Cannot Apply to the Facts Pleaded Here

The language of the statute is clear. Section 12(2) provides that an action shall lie to recover the consideration paid or for damages against any person who "sells a

security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication" which is false or misleading. Some of the defendants sold real estate to the plaintiffs and other defendants entered into contracts to care for that real estate. The Court below decided (contrary to what we believe to be correct, see pp. 6, 7, *supra*) that these arrangements constituted "securities" under the broad phrase "investment contract" in the definition contained in the Securities Act of 1933 (§ 2(1)). But the complaint here does not allege facts showing that the "securities" in question were sold "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails". For, accepting the allegations of the complaint, the sales involved were completed before use of the mails, and the mails were used only for delivery after sale. *A fortiori* the sale was not made "by use of" interstate commerce or the mails "by means of" a prospectus or oral communication which is false or misleading. There is no allegation whatsoever that means or instruments of transportation or communication in interstate commerce were used. There is also no claim that a prospectus was employed or required. Compliance with the statute is sought to be based solely on "use of the mails" for delivery of securities after sale, and on *prior* "oral communication" involving neither the use of the mails nor interstate commerce. This does not meet the test of the statute which requires that the sale be made *by use of* the mails *by means of* a false or misleading communication.

(1) The securities were not sold *"by the use of the mails"* as required.

The facts pleaded are merely that the plaintiffs and certain of the defendants entered into face to face transactions in Hidalgo County, Texas; that as a result of those

transactions the defendant Pummill Development Company sold the plaintiffs certain real estate and trees to be planted thereon; that the defendant Pummill Management Company agreed to care for the trees. *The contracts of sale of real estate and for the care of the trees were entered into face to face in Hidalgo County, Texas. The sales were thus completed without use of the mails or interstate commerce in any way.* It was only, as the complaint alleges (¶ V, R. 11, 12), "after" the sale that the mails were used to deliver the recorded deeds and the completed contracts to the purchasers as their evidence of the transaction which had been previously concluded. On these facts, the sales cannot properly be said to have been made "by the use . . . of the mails".

The use of the mails was not "to sell" the security as required. It was to transmit evidence of a previously completed sale. The concept of "delivery after sale" is distinct and different from the concept of "sale". It is something that occurs not as a part of the sale but "after" the sale.

The Congress understood this difference and when it intended to apply the Act to delivery of securities after sale, it said so. Thus in Section 5 of the Act dealing with the necessity for registration of new public issues of securities with the Securities and Exchange Commission, registration is required where the facilities of interstate commerce or the mails are used to carry securities *"for the purpose of sale or for delivery after sale . . ."* See Section 5(a)(2), 15 USC § 77e(a)(2). See also § 5(b)(2), 15 USC §77e (b)(2). The specific reference to "delivery after sale" in Section 5 and its failure so to provide in Section 12(2) clearly establishes that Section 12(2) cannot be read to include delivery after sale. The language of Section 5 establishes that "delivery after sale" is something different from and subsequent to the sale itself and not covered by

Section 12(2) which deals only with *sale* by use of the mails.[8]

This being so, the Section does not apply and the complaint must fail, without more. However, we shall also establish that the complaint fails to meet the statute in another respect.

(2) The securities were not sold *"by the use of the mails, by means of a prospectus or oral communication"* as required.

Plaintiffs contend that certain defendants sold the "securities" here involved "by the use of the mails [i.e., the delivery of the security after sale], by means of a[n] . . . oral communication (the face to face oral communications made in the process of negotiating the sale but before the use of the mails) . . ." The idea that the facts pleaded may be properly so described involves a complete distortion of the ordinary meaning of language.

We can present no clearer analysis than did the Seventh Circuit in *Kemper* v. *Lohnes*, 173 F. 2d 44, 45 (1949), as follows (quoted by the District Court R. 43-44):

> "The phraseology of the section as applied to pertinent allegations of the complaint may be reduced to read that any person who 'sells a security . . . by the use . . . of the mails, by means of . . . oral communication . . .' This must be so because it is not claimed that

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[8] The definition of sale also clearly excludes the concept of delivery. Section 2(3) of the Act states that the terms " 'sale', 'sell', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value;" 15 USC § 77b(3). The Second Circuit in *Schillner* v. *H. Vaughan Clarke*, 134 F. 2d 875, at 877, stated, that a delivery of a security was a "disposition" of a security. This is incorrect. Note the facts in the present case. The real estate here was deeded to the purchasers on the date they entered into the contract of purchase and was then recorded in the purchaser's name in the local court. All rights were vested at this time. No rights were disposed of or acquired as a result of the subsequent mailing of the deed. The care contracts likewise represented an obligation fully entered into by the parties face to face. That obligation was neither increased nor diminished by sending evidence of the agreement to the plaintiffs through the mail several weeks later.

'any means or instruments of transportation or communication in interstate commerce' was used other than that of the mails, nor is it claimed that there was any untrue statement 'by means of a prospectus.' The untrue statement, as alleged, was by means of an 'oral communication.' Of course, it is evident that an untrue statement made by 'oral communication' cannot take place through the mails, which we think indicates that the section does not contemplate the inclusion of an 'oral communication' in connection with 'use of the mails.' "

"Now to approach the matter from another angle. Assuming that an 'untrue statement' is the gravamen of the cause, as we think it is . . . such untrue statement must be made either (1) 'by means of a prospectus' or (2) by 'oral communication,' and in turn these two means of imparting an untrue statement must be made (1) 'by the use of any means or instruments of transportation or communication in interstate commerce' or (2) 'by the use . . . of the mails.' It appears to us, in fact we think it unreasonable to think otherwise, that 'by the use . . . of the mails' was employed solely in connection with 'by means of a prospectus', as the latter term is defined in the Act. Sec. 77b(10) states: 'The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio . . .' Thus the matters included in this definition are written and such as are commonly sent through the mails. An oral communication cannot be sent through the mails, and it is unrealistic to associate such a communication with the use of the mails.

"Of course, the phrase 'oral communication' must be recognized and given a place in construing the section, but that may be done by associating the term with a means of 'communication in interstate commerce'. Sec. 77b(7) states: 'The term "interstate commerce" means trade or commerce in securities or any transportation or communication relating thereto among the several States . . .' This certainly would include telephone conversations as means of communication in interstate commerce . . ."

In *Schillner* v. *H. Vaughan Clarke*, 134 F. 2d 875, 877 the Second Circuit adopted a contrary view because, in part at least, it believed it unreasonable to construe the term "oral communication" to "reach only interstate telephone calls". But it is by no means unreasonable so to limit the application of the phrase "oral communication". Securities sales in interstate commerce at which the Act was directed, are conducted by three major normal means of communication: (a) the interstate mails; (b) the interstate telephone (*Cf. Murphy* v. *Cady*, 30 F. Supp. 466 (D. Me. 1939)); and (c) the interstate telegram.[9] The phrase "prospectus or oral communication" covers all three normal methods of communication. "Prospectus" covers two and "oral communication" the other. Certainly this is a reasonable and natural way of treating the two phases of the problem—the written and the oral communication—in a statute of a national government dealing with interstate commerce. To apply the phrase "oral communication" to a *face to face* conversation, as the Court in *Schillner* did, is to construe the statute as though it were adopted by a local government rather than a federal government under a delegated power over interstate commerce.

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It has also been argued in the courts below that Section 12(2) must be construed as broadly as certain other provisions of the securities laws, e.g., Section 17(a) of the Securities Act of 1933, making fraud and false statements unlawful, and Section 10(b) of the Securities Exchange Act of 1934. It should perhaps be sufficient to say that the language of those provisions is quite different from that of Section 12(2). (See the opinion of the District Court R. 45). Had Congress intended the same result in both cases, it could easily have used the same language. It is therefore

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[9] See the statement of Rep. Greenwood, 77 Cong. Rec. 2914: "All lines of publicity, whether by use of the mails, the telegraph, the telephone, radio, prospectuses or any other form of publicity that will lead an investor to purchase securities have been covered by the bill."

The Act includes radio with the written rather than the oral communications. See the definition of prospectus (Section 2(10)) in the quotation from the *Kemper* case, *supra* p. 13.

unnecessary to consider whether there may be reasons for construing those statutes more broadly.[10] Further, this Court has never decided that, under these differently phrased provisions, federal jurisdiction is invoked by a use of the mails to deliver a security after the entire transaction of sale has been completed otherwise. Indeed, even under the all inclusive mail frauds statute, there comes a point where a transaction complained of is completed and use of the mails thereafter no longer has any relation to the objective of the statute. Cf. *Kann* v. *United States*, 323 U.S. 88.[11]

II. Investors Will be Adequately Protected Under the Petitioner's Construction of the Statute

No issue of protection of investors is involved. To refuse jurisdiction here would merely remit the investor to a clearly adequate remedy under state law. If the land sales and care contracts are indeed securities under the definition of the Securities Act of 1933, they will in all likelihood also be so held under the identical definition of the Texas Blue Sky Law (Texas Revised Statutes 600a § 1(a)). Plaintiffs could, in that event, enforce liability for misrepresentation in any competent court of the State of Texas under the civil liabilities provision of that law (id. § 33a).[12] If the

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[10] See pp. 17, 18, *infra*.

[11] There was some argument in the respondents' brief in opposition to the effect that the statements of expenditures for the care of the trees which were delivered monthly after care had commenced (thus commencing at least two months after the "sale" in question) had some relevancy to the application of the Securities Act. The court below did not rely on these mailings, apparently regarding them as too remote from the sale and limiting its ruling to the "delivery of the deeds and [care] contracts" (R. 54). Plainly, if the real estate and care arrangements represented a security, that security was sold when the contracts were entered into. The care statements were merely a report of actual expenditures which, under the care contract, obligated the purchasers to replenish their deposits in the local bank in Hidalgo County, Texas (R. 30). They were not prospectuses, a prospectus being defined in the Act as a writing "which offers any security for sale" § 2(10). Plainly, the "securities", if such they were, were not offered or sold by means of these statements of amounts expended for care, and no jurisdiction under Section 12(2) arises from the mailing of these statements of expenditure.

[12] See Loss, Securities Regulation, pp. 962-982, for a discussion of the civil liabilities provisions of various Blue Sky laws with frequent reference to Texas.

transactions are not securities transactions but, as we believe, simple real estate sales, the Texas law on rescission for false statements or fraud and deceit is surely adequate.[13]

Certainly under the differing remedies provided by state law and by Section 12(2), the plaintiffs rights may vary somewhat. But in general the state court remedies will give substantially equivalent relief. This is objectively established here by the fact, noted in the opinion on the district court (R. 37 n. 4), that where the same counsel in a similar litigation against the same defendants, represented out of state plaintiffs, they sued in the federal court only on diversity of citizenship. In that case, they relied on Texas common law and made no mention of the Securities Act.

Accordingly no reason related to the protection of investors exists for extending federal jurisdiction to purchasers in local real estate transactions such as the present one. The remedies under state law are adequate.

III. To Sustain the Ruling Below Will Extend Federal Jurisdiction to a Host of Cases Having No Relation to the Objective of the Securities Act

The definition of "security" in the Securities Act of 1933 is in the most inclusive terms. It specifies as a security for example "any note, . . . evidence of indebtedness, . . . investment contract" besides the usual "stock," "bond, debenture, etc." The present case shows some of its scope as applied to real estate transactions.[14] The Ninth Circuit has recently held that the Act applies to a simple promissory note. *Llanos* v. *United States*, 206 F. 2d 852 (Sept. 4,

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[13] The relative advantages and disadvantages from the plaintiff's point of view of an action under Section 12(2) and under the common law are considered in Loss, *op. cit., supra*, at pp. 997-1001.

[14] We should perhaps also mention its application to the animal world. *S.E.C.* v. *Payne*, 35 F. Supp. 873 (SDNY 1940) (silver foxes); *Hollywood State Bank* v. *Wilde*, 70 Cal. App. 2d 103, 160 P. 2d 846 (1945) (chinchillas); *Stevens* v. *Liberty Packing Corp.*, 111 N.J. Eq. 61, 161 Atl. 193 (1932) (rabbits).

1953). The purchase of a dwelling house is almost invariably accompanied by the execution of a bond and mortgage which is plainly an "evidence of indebtedness".

The ruling below would require the federal courts to open their doors to private litigants who claimed that false or misleading oral statements were made to them before they agreed to advance the mortgage money. For in the normal case the bond and mortgage will be recorded and delivered by mail. Similarly under that ruling, holders of promissory notes of their neighbors could not be barred from the federal courts on claims of oral misrepresentations e.g. of financial standing, provided the promissory note was dropped in the mail. In such cases also the debtor could be pursued by federal court process throughout the United States, if he had moved away from the place where the "sale" of the "security" took place. And all this without even any limitation as to jurisdictional amount or diversity of citizenship. *Deckert* v. *Independence Shares Corporation*, 311 U.S. 282.

Plainly the Congress in the Securities Act of 1933 intended no such mares nest for the overburdened federal judiciary.[18] The state courts are available and adequately equipped to deal with such local transactions.

The broad definitions and extended scope of the Act may serve a purpose where the governmental discretion of the Securities and Exchange Commission or the Attorney General may choose the case for litigation on the basis of public

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[18] Judge Allred referred (R. 45) to "the pressure of constant trial work for the past three months" and noted (R. 37, n. 4):

> "In five similar cases filed against the same principal defendants here, (in which jurisdiction was grounded on diversity of citizenship), practically the same allegations of conspiracy and fraud were made. After a jury trial lasting nearly four weeks, there were findings of no conspiracy and a hung jury on the issue of fraud by the selling company."

The condition of the dockets in the other federal courts needs no elaboration. See ANNUAL REPORT OF DIRECTOR OF ADMINISTRATIVE OFFICE OF THE FEDERAL COURTS TO THE JUDICIAL CONFERENCE OF THE UNITED STATES, SEPTEMBER 1953, particularly the summary at page 1 entitled "The Still Unmet Need for More Judges."

interest.[16] But here a right was given a private litigant to pursue at his own pleasure unlimited by governmental or court restraint. We believe the Congress wisely limited that right to a showing of grounds of jurisdiction which gave substantial evidence that the problem was of more than local significance. The Court should not depart from that limitation. To sustain the decision below would run the danger of converting a great statute designed for the protection of investors against interstate securities fraud into a device for choking the federal courts with controversies purely local in nature.

IV. The Congressional Purpose Is Not Served by the Construction Adopted by the Court Below.

Indeed there is no serious argument that the statute on a normal reading would cover the transaction in question or that any substantial purpose would be served by the construction of the court below. Rather it is the contention of those supporting the ruling below that the language used by the Congress was inartistic, that it meant something different from what it said, and that the general policy considerations which occasioned the passage of the Securities Act required a "liberal" construction of the statute to accord with those policy considerations rather than the language the Congress used.[17]

The argument is baseless. There is no legislative history of Section 12(2) itself which helps those who would read the statute more broadly than its terms. The Section

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[16] See Section 20(b) authorizing injunctive proceedings by the Commission "in its discretion" and criminal proceedings by the Attorney General "in his discretion".

[17] *Cf.* Loss, *Securities Regulation*, p. 1062. In agreeing with the construction adopted by the court below the author finds it necessary to preface his position with a statement that "Section 12(2) is not a model of draftsmanship".

But *Cf.* the statement of Rep. Greenwood, 77 Cong. Rec. 2913: "I never have read a bill that appeared to be more carefully drawn, with reference to all of its features and technicalities, than this bill."

appeared substantially in its present form in the bill as reported by the House Committee and no discussion of the specific relation of the section to the use of interstate commerce or the mails appears in the reports or debates. The proponents of the view adopted by the court below are therefore driven to argue from the assumed purposes of the Act in general.

That argument, as stated in the *Schillner* case, *supra,* is that in the Securities Act the Congress "meant to exert its power to the full constitutional extent permitted by the commerce clause and the postal clause" 134 F. 2d at 878. Were this a correct statement of the congressional purpose, there might be reason to distort the language employed by the Congress in an attempt to achieve the assumed objective. But there is no warrant in the legislative history, in the conditions leading to the passage of the Act or in general public policy for such a conclusion. Instead these criteria establish that the Congress in the Securities Act did not intend to "affect transactions beyond the need of public protection" by the federal government (H. Rep. 85, 73d Cong., 1st Sess., p. 7). The purposes of the Congress would be better served by the construction advocated by petitioners here.

Indeed, the approach of *Schillner* and of the court below ignores the basic nature of our federal system. It does not heed the admonition of this Court that "in ascertaining the scope of congressional legislation a due regard for a proper adjustment of the local and national interests in our federal scheme must always be in the background". *FTC* v. *Bunte Bros., Inc.,* 312 U. S. 349, 351. It does not consider that when Congress does see fit to regulate local business "and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating are reasonably explicit and do not entrust its attainment to that retrospective expansion of meaning which properly deserves the stigma of judicial legislation." *Kirschbaum* v. *Walling,* 316 U. S. 517, 522.

1. *The Law Was Intended Primarily to Deal With the Area of Interstate Commerce Beyond the Power of the States to Control.*

Although the Securities Act of 1933 involved a great extension of the scope of federal regulation, the Congress was not embarking on a field that was unoccupied by the states. It was faced with no necessity, and it expressed no desire, to extend its power to every local transfer of shares well within the regulatory power of the states. Rather in adopting the Securities Act of 1933 the Congress was acting in the best conservative tradition of our federal system. It acted to bring the power of the federal government to bear in the area where the states were powerless to act.

The inapplicability of the Act to transactions like the present was specifically declared on the floor of the House on two occasions. First:

> "Mr. Parker of New York.[18] The law does not affect intrastate business in the least.
>
> Mr. Britten. Of course it does not . . ." 77 Cong. Rec. 2921.

And again:

> "Mr. Cannon [of Wisconsin]. Within the last few months I tried a case in which an influential high officer of a bank obtained from a poor man his life savings by selling to him securities he either knew or, in the exercise of due care, ought to have known were worthless.
>
> • • •
>
> Mr. Mott. Did the transaction of which the gentleman speaks take place entirely within his own State?
>
> Mr. Cannon of Wisconsin. Yes.

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[18] Senior Republican member of the House Committee on Interstate and Foreign Commerce, and a proponent of the bill. The Committee was unanimous in favor of this bill in general, two members dissenting from a provision which was not incorporated in the law as passed. See H. Rep. 85, 73d Cong., 1st Sess.

> Mr. Mott. Is it the gentleman's idea that such a transaction comes within the purview of this legislation?
>
> Mr. Cannon of Wisconsin. Oh, no; I am just citing that as an illustration of the activity of some of our bankers." 77 Cong. Rec. 2941.

These clear statements of intention not to deal with local transactions of the type here involved are mere expressions of the obvious.

It should be remembered that state Blue Sky laws regulating the Securities Act antedated the Securities Act by some twenty years and that when the Securities Act was passed forty-seven of the forty-eight states had such laws. Loss, *Securities Regulation*, pp. 18, 19.[19] These laws had been sustained by this Court under the due process clause. *Hall* v. *Geiger-Jones*, 242 U. S. 539.

The Congress was of course aware of the existence of this state legislation.[20] It specifically provided that it was not usurping this field, and that the rights it gave to investors were "in addition to any and all other rights and remedies" existing under state laws (Section 16) and that "nothing in this title shall affect the jurisdiction" of any State Blue Sky Commission "over any security or any person" (Section 18). Plainly it was not seeking to duplicate state regulation in order to give investors a new forum in the federal courts for grievances already adequately cognizable under state laws.

Rather it built on this foundation of state regulation by adding its own scheme to govern the area which the states could not reach—interstate trade in securities. It sought to "supplement" the blue sky laws of the states and make it "impossible for dealers and underwriters to evade the State laws by the shipment of their securities and prospectuses and other material in interstate commerce or through the

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[19] Nevada was the exception.

[20] See Rep. Mapes, 77 Cong. Rec. 2912: "Of the 48 states in the Union, all but 1 have some sort of blue-sky legislation."

mails". Rep. Mapes, 77 Cong. Rec. 2912. For the Congress was advised that the great national trade in securities was unregulated because it could not be reached by the individual states, and that in this field state regulation needed to be supplemented by a national law. The Hearings before the House Committee on Interstate Commerce were opened by the testimony of Hon. Houston Thompson, as chief spokesman in favor of the bill, with a statement to this effect.[21] Similar statements were made in floor debate.[22]

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[21] At page 10 of the Hearings on H. R. 4314, March 31, 1933, he stated as follows:

> "These 'blue sky' laws of the States have failed, as is very obvious, in meeting the great problem, and that is due to a number of facts, First of all, a lack of unifomity [sic] of laws, and, second, the fact that, on the subject of extradition, those who are putting out securities can sell and send them across the State line into another State without being able to be reached so far as a criminal penalty is concerned. You only extradite and bring a man back after he has fled from a State. Well, nowadays securities can be sold from New York State over into Illinois, and the consummation of the contract can only be terminated by the consent of the seller from New York, and in that way the person in Illinois suffers if the security is not a good one; and yet the wrongful act has been committed outside the State, and there is no way of reaching the person outside of the State."

See also the statement of Robert E. Healy, General Counsel of the Federal Trade Commission, later a Commissioner of the Securities and Exchange Commission. Hearings on S. 875 at 214-215.

[22] See Rep. Wolverton, 77 Cong. Rec. 2931 as follows:

> "The failure to prevent such losses is not due to any lack of stringency in the statutes already enacted by the several States, but, in a large measure, because of the inability of State laws to reach interstate transactions in such securities. Fraudulent securities are largely sold and distributed by agencies of communication which extend beyond state lines. The jurisdiction of State regulatory measures is necessarily confined or limited to transactions within the State. The channels of interstate commerce are open and free from such State regulation and control. Thus securities that may be precluded from sale in an intrastate transaction are immune when the transaction extends beyond the boundaries of that particular State."

Mr. Wolverton was a member of the Committee on Interstate and Foreign Commerce which was in charge of the bill.

See also Rep. Chapman, also a member of the Committee, 77 Cong. Rec. 2935; Rep. Greenwood, 77 Cong. Rec. 2914: "No state has power to control publicity of securities. Some issues come from abroad, some of them are national in character, and no state has such authority or power.".

The Act was a response to a presidential recommendation "for Federal supervision of traffic in investment securities in interstate commerce," and for full disclosure with respect to "every issue of new securities to be sold in interstate commerce". See H. Rep. No. 85, 73d Cong., 1st Sess., pp. 1, 2.[23]

The entire scope of the Act was directed at the problem of interstate sales. Registration under the federal law was required only if interstate commerce was employed in the sale or delivery after sale. But local concerns selling to citizens of their own state were left to local regulation even though they used the mails in the process (Section 5(c) of original Act; Section 3(a)(11) of amended Act).

As the House Committee pointed out, H. Rep. 85, 73d Cong., 1st Sess., p. 7:

> "Section 5(c) also exempts sales within a State of entire issues of local issuers. In view of these exemptions and the restriction of the bill's application to new offerings, the bill does not affect transactions beyond the need of public protection in order to prevent recurrences of demonstrated abuses."

2. *The Purpose and Effect of the Partial Reliance On the Postal Power.*

Since the constitutional scope of the commerce clause of the federal Constitution was not in 1933 as clear as it is today, jurisdiction was buttressed by the alternative provisions relying on the use of the mails, and supplemented by a separability clause (Section 26).[24]

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[23] See this Report (of the House Committee on Interstate and Foreign Commerce reporting the bill favorably to the House,) at p. 3: "Resting upon the power of Congress under the Constitution over interstate and foreign commerce, the bill closes the channels of such commerce to security issues unless and until a full disclosure of the character of such securities has been made". See also Rep. Rayburn, 77 Cong. Rec. 2918. See also, e.g., S. Rept. 47, p. 1, referring to the basic policy to inform the investor concerning "securities to be offered for sale in interstate and foreign commerce"; *id.* p. 2, the statement that the Act requires registration "when a person or corporation is about to sell securities in interstate commerce."

[24] *Cf.* Rep. Beck, 77 Cong. Rec. 2935-2939, particularly the reference (at 2937) to the doctrine of *Paul* v. *Virginia*, 8 Wall. 168.

The constitutional problems surrounding the time of its enactment have left their mark on the Securities Act of 1933. Although the commerce power has now been confirmed in its broadest scope, Section 12(2) would still apply to a purely local transaction where a prospectus was sent through the mails within a single state and was used to sell a security. In such a case the courts would of course be required to apply the Act in accordance with its terms although the basic objectives of the Congress would not be advanced. We suggest no limitation of the language of the Congress in such cases.

But where as here the language rather commands a conclusion that federal jurisdiction does not exist, there is no occasion to extend the language of the statute beyond the objectives of the Congress or "beyond the need of public protection". *Cf.* H. Rep. No. 85, 73d Cong., 1st Sess., p. 7.

CONCLUSION

The language of the statute is plain. It does not create a cause of action in the federal court under the circumstances of a face to face transaction solely within a state. The use of the mails to deliver documents evidencing a previously completed transaction does not bring the matter within the Act. An adequate remedy exists under the law and in the courts of the State of Texas. The decision below unnecessarily extends federal power beyond the purposes intended by the Congress. The decision below would open the federal courts to much local litigation. The judgment of the Court of Appeals should be reversed with directions

to affirm the judgment of the District Court dismissing the complaint.

Respectfully submitted,

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APPENDIX

Section 5 of the Securities Act of 1933 (15 U.S.C. § 77e) reads as follows:

"Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10."

Section 22(a) of the Securities Act of 1933 (15 U.S.C. § 77v(a)) reads as follows:

"Sec. 22. (a) The district courts of the United States, the United States courts of any Territory, and the Supreme Court of the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action

may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts."

Section 2(1) of the Securities Act (15 U.S.C. § 77b(1)) reads as follows:

"Sec. 2. When used in this title, unless the context otherwise requires—

(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Section 2(10) of the Securities Act of 1933 (15 U.S.C. § 77b(10)) so far as here relevant provides as follows:

"(10) The term 'prospectus' means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio, which offers any security for sale; . . ."